



# Actuary Report

## 2006 WSLEA Annual Conference

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State Actuary



State of Washington  
Office of the State Actuary

May 12, 2006

### Discussion Topics



- LEOFF 1 funding update
- LEOFF 1 CPI
- SHB 2688 (C 350, L 06, PV)
  - Repeal of 60% cap
- Gain-sharing

## LEOFF 1 Funding Update



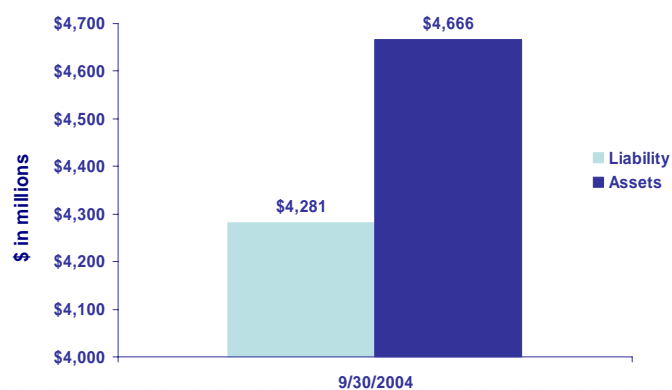
- September 30, 2004 - most recent valuation date
- 2005 valuation results - available this fall
- 13.88% rate of investment return (ROR) for the valuation year
- 17.5% ROR for the 2005 valuation year (preliminary)

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2

## Funded Status

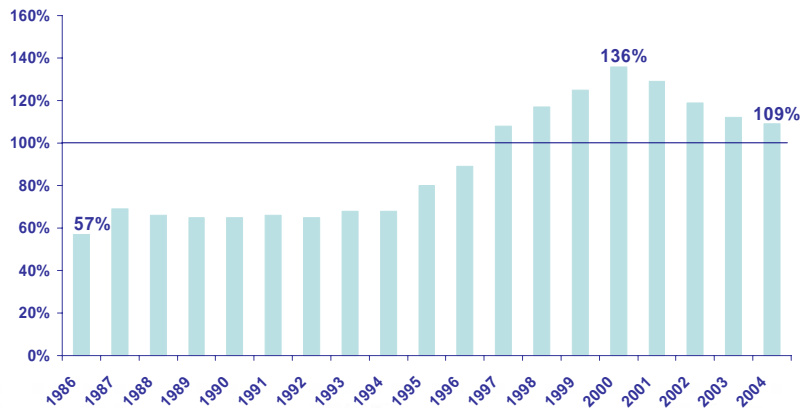


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3

## Historical Funded Ratios

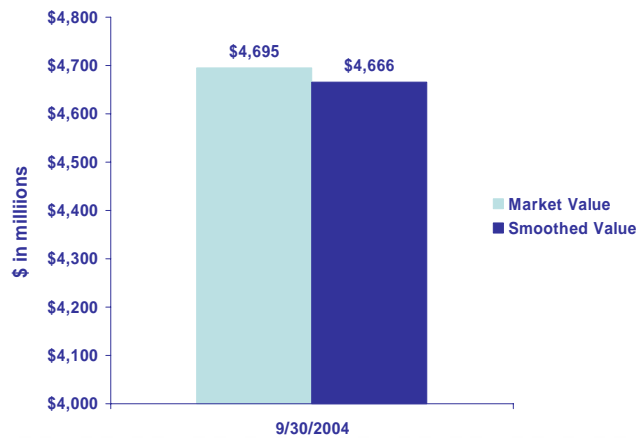


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4

## Assets

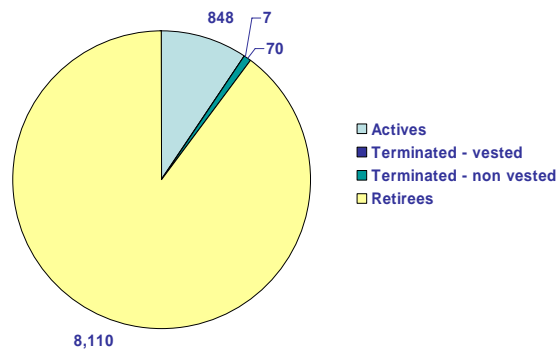


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5

## Participant Data



9/30/2004

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6

## Key Assumptions



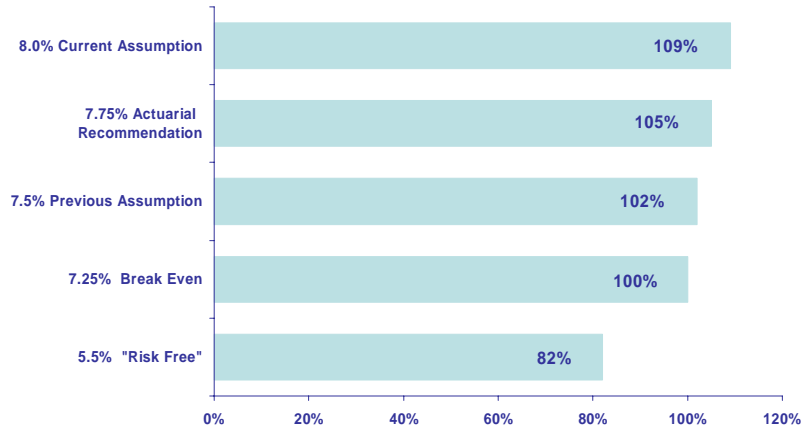
- 8% rate of investment return
  - The "valuation interest rate"
- 4.5% general salary increases
- 3.5% inflation
- All unchanged from previous year's valuation

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7

## Funded Ratio at Select Interest Rates



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8

## Funding Policy



- No contributions required when plan is fully funded
  - Plan is fully funded as of latest valuation
- 100% funded ratio is current target
- Plan will likely move in and out of full funding under current asset allocation policy

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9

## Questions on Funding?



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## LEOFF 1 CPI

- Consumer price index (CPI) most commonly used measure of price inflation
- Price inflation is a symptom of inflation
- The 2006 LEOFF 1 COLA reflects price inflation from 2004 to 2005
  - Lag in each annual adjustment

## LEOFF 1 CPI



- RCW 41.26.240 specifies applicable index
- Index is calculated, maintained, and published by U.S. Department of Labor, Bureau of Labor Statistics (BLS)
- OSA forwards annual COLA letter to DRS

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12

## CPI Basics



- Two major series produced
  - CPI-U
  - CPI-W
- CPI-U measures price inflation
  - Urban consumers
- CPI-W measures price inflation
  - Urban wage earners and clerical workers

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13

## CPI Basics



- CPI-W is used for LEOFF 1
- Annual price inflation measured by annual change in prices for a “market basket” of goods

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14

## How the Market Basket is Determined



- Consumer Expenditure Surveys
  - 1993, 1994, and 1995
  - 5,000 families per year in quarterly interviews
  - 5,000 families per year keep expenditure diaries
  - 16,800 families over the three-year period provide point-of-purchase information (Safeway, Costco, etc.)

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15



## When the Market Basket is Changed

- When the Consumer Expenditure Surveys show significant differences in consumption patterns
- Typically once a decade

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16

## How CPI Prices are Collected and Reviewed

- Each month BLS data collectors visit
  - Retail stores
  - Service establishments
  - Rental units
  - Doctors' offices
- Record prices of about 80,000 items

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17

## Whose Buying Habits Does the CPI-W Reflect?



### ■ Wage Earners and Clerical Workers

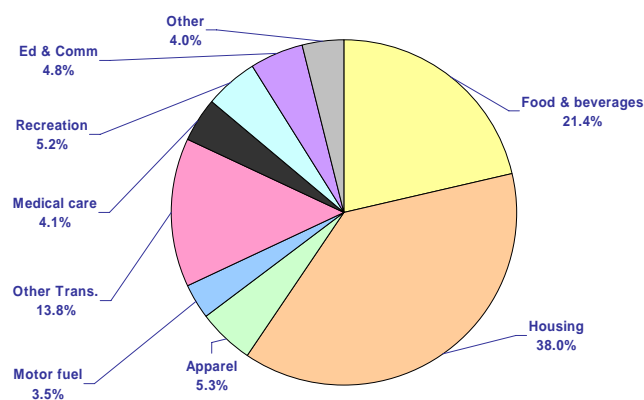
- About 32% of the population (subset of CPI-U)
- More than half the household income from clerical or wage occupations
- One of household must have been employed for 37 of the last 52 weeks

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18

## CPI-W Market Basket

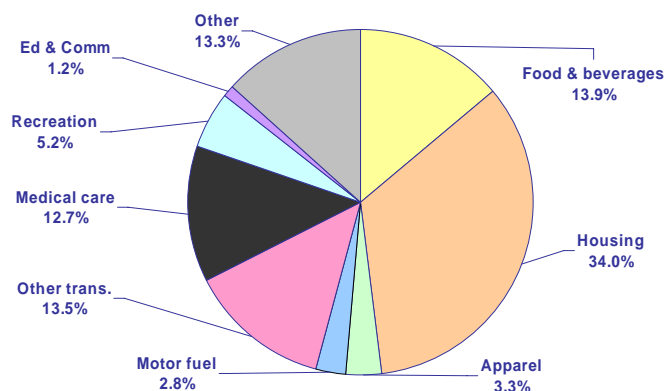


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19

## Retired Market Basket

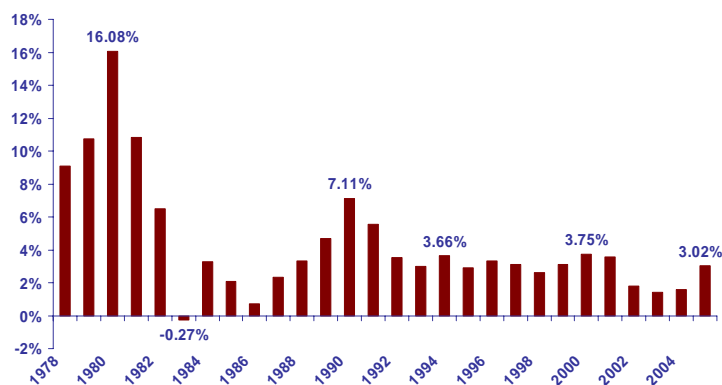


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20

## Annual Percentage Changes Seattle CPI-W: 1978-2005



Source: U.S. Department of Labor, Bureau of Labor Statistics

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21

## 2005 CPI-W for Select Areas



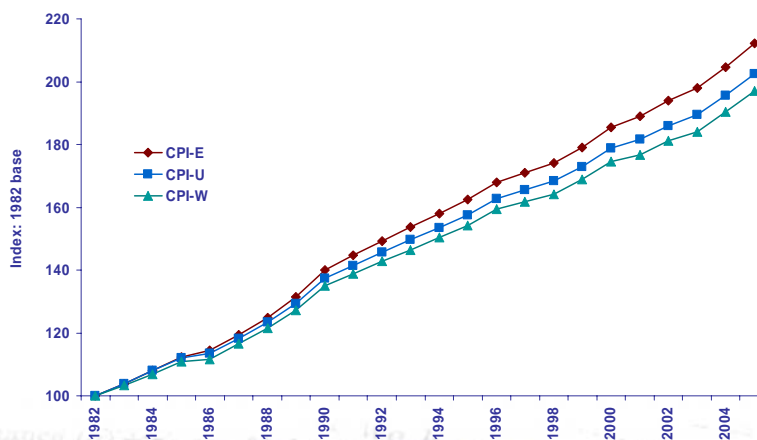
Area	% Change
San Francisco	2.1%
Denver	2.4%
Phoenix	3.1%
Los Angeles	4.4%
Miami	5.0%

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22

## CPI-U, CPI-W, and CPI-E\* U.S. Average: 1982-2005



\* CPI-E: Unpublished index for consumers age 62 and older

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23

## LEOFF 1 CPI - Defined



- CPI-W = Urban Wage Earners and Clerical Workers (Current Series)
- Not seasonally adjusted
- Area = Seattle-Tacoma-Bremerton
- Base = Alternate (base period = 1967)
- All items
- <http://www.bls.gov/cpi/home.htm>

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24

## Questions on LEOFF 1 CPI?



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## SHB 2688



- Removes 60% cap on final average salary for current actives or members who return to work
- Zan Johnston from DRS will cover benefit provisions
- I will discuss legislative/policy development and fiscal impact

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26

## Legislative/Policy Development



- HB 2688 introduced as SCPP request legislation with the following provisions
  - Repealed the 60% cap effective July 1, 2006
  - Reinstated 6% member and employer contribution rates July 1, 2007
  - Formed executive task force to select and implement one or more funding vehicles for post-retirement medical benefits

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27

## Legislative/Policy Development



- Passed the House with an amendment
- The Senate passed the House bill
  - Removed reinstatement of contributions
- Bill passed the House with Senate amendment
- Section pertaining to taskforce vetoed
- Signed into law as Chapter 350, Laws of 2006

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28

## Fiscal Impact



- Cost of the bill funded by existing surplus
- The cost was estimated at \$22 million
  - Increase in present value of projected benefits
  - Surplus was \$385 million at 9/30/2004
  - Cost represents about 6% of surplus

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29



## Questions about SHB 2688?



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## What is Gain-Sharing?



- Non-contractual benefit provision
  - Provides increased benefits when gain-sharing is triggered
- Applies to
  - PERS 1
  - TRS 1
  - All Plans 3



## How is Gain-Sharing Triggered?



- “Extraordinary investment gain”
  - Compound average rate of return over the previous four state fiscal years exceeds 10%
- Calculation performed in January of even-numbered years

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32

## What Does it Provide?



- One-half of “extraordinary gain” distributed as benefit improvements
- PERS 1 and TRS 1
  - Permanent increase in Plan 1 Uniform COLA
- Plan 3
  - Distribution to eligible member defined contribution accounts

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33

## Why Does it Have a Cost?



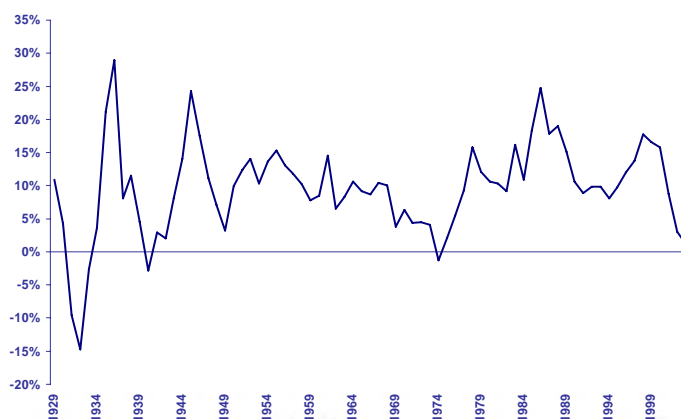
- Returns in excess of 10% are far from extraordinary
  - Necessary to support 8% interest assumption
- Skimming-off these returns reduces the investment return available to support underlying benefits

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34

## Investment Rate of Return by Current Asset Mix: 1929-2003 Four-Year Averages



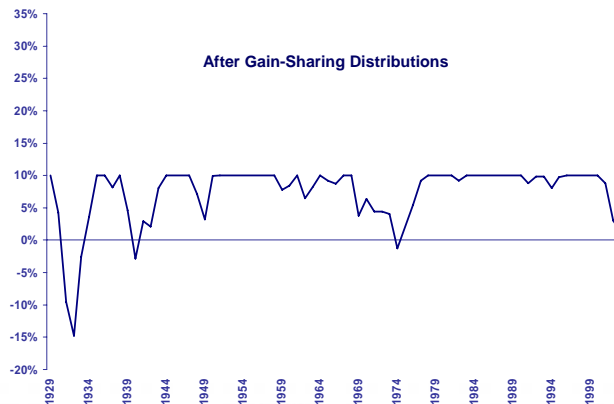
Average Compound ROR = 9.4%

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35

## Investment Rate of Return by Current Asset Mix: 1929-2003 Four-Year Averages



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36

## What is the Cost?



- Increases the Plan 1 unfunded liability by \$908 million (present value)
- Increases Plan 3 liability by \$672 million (present value)
- The Legislature suspended the liability
- General-fund state impact in 05-07 would have been \$147 million in additional employer contributions (\$340 million for all sources)

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37

## Next Steps



- Suspension of the liability will expire at end of current biennium
- Resolution is expected as part of 07-09 biennial budget
- SCPP has recommended a repeal and replace strategy for two successive years

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38

## Questions on gain sharing?



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## Contacting OSA



- Our website
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